182993 - Alternatives for Islamic Banks to Avoid Late-Payment Charges

the question

You mentioned previously, in question no. 140603 , that it is not permissible for an Islamic bank to stipulate a penalty to the customer in order to guarantee that he will pay the instalments that he owes to the bank for financing a purchase at the times agreed upon between the two parties. My question is: Is there any alternative that is permissible according to Islamic teachings, instead of a financial penalty, that Islamic banks can stipulate that the customer should pay in real estate transactions such as these, in order to guarantee that he will pay instalments on time?

Summary of answer

Alternatives for Islamic Banks to avoid late-payment charges include: 1- the bank appointing someone as a guarantor; 2- the bank taking something in mortgage; 3- the bank stipulating that the customer should open an account in the bank; and 4- the bank putting the customer on a blacklist.

Detailed answer

Praise be to Allah.

Is it permissible for an Islamic bank to impose a penalty for late payments?

If the bank sells a property to the customer by instalments, it is not permissible for them to stipulate a late-payment penalty , because the instalments are a debt that the customer owes, and charging a penalty for a late payment of a debt comes under the heading of Riba.

Alternatives for Islamic Banks to avoid late payment charges

- It is permissible for the bank – in order to guarantee its rights – to appoint someone as a guarantor (someone other than the borrower) from whom the bank can demand payment, if the one who owes money delays payment or takes too long to pay.
- The bank can also take something in pledge, which includes taking the purchased item itself as a mortgage, so it will be held until the payments are complete , whilst allowing the customer to continue using it. The benefit of this mortgage is that the customer cannot sell it. It is permissible to stipulate that if he is unable to pay , then the bank will sell the item that is held as a mortgage without needing to go to court.
- Another means of guaranteeing payment is stipulating that the customer should open an account in the bank, and allow the bank to have access to it, so that it can take instalments directly from it as soon as his salary is diposited into the account (direct debit).
- And another means is putting the customer on a blacklist, and agreeing with all other banks that they will not deal with those whose names appear on this list.

And Allah knows best.